# COMMUNICATIONS +

## Briefing Note

# Why CFO Pay Matters

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**MONTIETH** & COMPANY

We're proud to have as a guest author of our May, 2019 Briefing Note Guy Jubb, Honorary Professor at the University of Edinburgh Business School, and a notable expert on executive compensation. In this piece, Mr. Jubb argues the merits of decoupling CEO and CFO pay criteria; further, that when establishing CFO pay more attention should be paid to sound internal controls and a professional culture.

For Montieth & Company and our global issues and crisis management work – especially when we are advising organizations who run into challenges resulting from running afoul of regulatory compliance – Mr. Jubb brings an informed and expert perspective.

**Montieth M. Illingworth, CEO, Montieth & Company**

# CFO pay deserves more scrutiny

**Guy Jubb, Honorary Professor, The University of Edinburgh Business School**

The annual general meeting season is now upon us. An ever-growing cadre of environmental, social, and governance (ESG) specialists, scalpels sharpened, join journalists in scouring annual reports to find egregious CEO pay to dissect and attack in the interest of good stewardship. More power to their elbows.

However, CFO pay and incentivisation should attract just as much, if not more, interest from investors when it comes to evaluating ESG risks. Although CFO headline pay will be less than that of the CEO, the nature of a CFO's responsibilities is critical to the sustainability and success of the company.

As the London-listed Carillion headed to the knacker's yard, the board minutes subsequently disclosed by the Joint BEIS and Department of Pensions Inquiry of the UK Parliament highlighted the contribution to the company's demise of 'sloppy accounting'. If the accounting had been first class, maybe Carillion would still be with us today. Indeed, the Inquiry Committee's Report drew critical attention to Carillion's use of 'aggressive accounting policies to present a rosy picture to the markets'[1] . The rest, as they say, is history.

**"It can give rise to inappropriate behaviours and judgements to manipulate the metrics ..."**

It is the CFO's executive responsibility to ensure that the quality of accounting is up to scratch and that the accounting policies are appropriate to the presenting of a true and fair view - not a rosy one. But as things stand, the CFO is generally incentivised to maximise total shareholder return or one or more financial metrics such as return on capital or earnings per share growth.

For a CFO, having too much compensation potential derived from these metrics can be perverse. It can give rise to inappropriate behaviours and judgements to manipulate the metrics that are more aligned with maximising the CFO's own short-term gains, rather than the sustainable success of the company. Arguably, it is small wonder that, too often, failings in internal controls, accounting processes and accounting policies are pinpointed as one of the root causes of corporate failure.

1. Paragraph 96

Against this background, it is surprising that investors and others rarely pay attention to the CFO's pay and its components. They seldom seem to recognise that within the C-suite, as well as the boardroom, it is the CFO who often has the greatest potential to act as powerful check and balance to curb the enthusiasm of an over-ambitious CEO, who often has a point to prove and has an unforgiving market to please.

In addition to that, the CFO is often the only executive director in the room with a professional accountancy qualification. When it comes to professional accountants their professionalism and professional commitment to the public interest should trump all. Sadly, too often the reverse is true and professionalism is trumped by the CFO's self-interest.

Going forward, compensation committees should be looking to decouple CFO pay criteria from those used for the CEO, as is the norm currently[2]. CFO pay policies should be tailored to their specific responsibilities and focus on performance indicators which ensure the good stewardship of the company's financial assets. They might include, for example, the maintenance of sound systems of internal controls and the promotion of a professional culture within the accounting and finance functions. Also, the number and nature of adjustments made at the behest of the auditors, which ideally should be based on an attitude of zero tolerance.

The bottom line, be you in Hong Kong, London or New York, is that CFO pay can be just as critical to the long-term sustainability and viability of a company as the CEO's. This is particularly the case when it comes to the metrics used for a performance related component to a CFO's pay. Compensation committees should do more to differentiate their approach to determining CFO pay packages relative the CEO and other executives. The CFO's executive responsibilities are different to the CEO's and more should be done to reflect this responsibility differential in how their performance is measured. To use the same structure for CFOs as for CEOs could be irresponsible, and can result in perverse incentives in which the seeds of corporate destruction are sown.




## Guy Jubb, Contributor

Guy Jubb is a chartered accountant, advisor and consultant, whose executive career has spanned merchant banking and fund management, latterly as Global Head of Governance & Stewardship at Standard Life Investments. Guy now focuses on thought leadership, writing, his relationships with the academic community as well as his advisory and non-executive roles.

He is an Honorary Professor at the University of Edinburgh, a Senior Adviser to the Conference Board, an independent non-executive of Mazars LLP, interim Chair of the European Corporate Governance Institute and a member of the Standing Advisory Group of the PCAOB, the US audit regulator.


2. For example, see the annual bonus structure and weighting for the CEO and CFO of BT Group plc as described on page 169 of the2018/19 Annual Report https://www.btplc.com/Sharesandperformance/Annualreportandreview/2018summary/documents/governance.pdf

# BRIEFING NOTE + Why CFO Pay Matters

## Communications Learnings

- Many corporations currently focus singularly on the optics of CEO pay. With proxy season well under way, that focus becomes acute. Looking forward, investors, and the news media, will increasingly looking beyond the CEO's paycheck and more and more into other levels of the C-Suite.
- At the same time, when executive pay is probed and there is a causal connection made between the perception of whether compensation levels and structures are appropriate and if not what that may have to do with the culture within the organization – the culture of the C-Suite in particular – an even larger communications problem looms.
- Can a harsh light brought on CFO pay have the same reputational impact on an organization as that of the CEO? Arguably, yes.

## Additional Resources

+ https://ecgi.global/working-paper/accounting-financial-stability-lessons-financial-crisis-and-future-challenges
+ https://www.ivis.co.uk/media/13874/Principles-of-Remuneration-Nov-2018-FINAL.pdf
+ https://www.standard.co.uk/business/anthony-hilton-directors-must-be-ready-to-use-their-muscle-a3632961.html

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